The FCA's Sustainability Disclosure Regime: A Practical Implementation Guide

E. Fund Launch and Distribution under the SDR

This is the fifth briefing in a series of alerts focused on the Sustainability Disclosure Requirements (SDR) regime. In this alert, we focus on the SDR's requirements relating to launching and distributing funds.

1. Fund Launch and Regulatory Approval

Firms in scope of the SDR will need to notify the FCA of their use of SDR labels before commencing use of the label. Firms will also need to notify the FCA "before or as soon as reasonably practicable after they revise or stop using a label". The FCA will only accept SDR label notifications via its Connect platform, and the notification will need to include information on the particular SDR label, the date on which the firm will start to use (or cease to use) the label and the applicable product reference number.

The FCA has confirmed that where a firm chooses to label a product the firm shall remain "responsible for its classification and ensuring the label is appropriate". The FCA goes on to note that its Fund Authorisation team will review, and may challenge, the application of any new fund submitted for authorisation, or amendments to existing funds. However, firms should not treat this review process as "an approval of the label". This is an important point for applicants – whilst the FCA's fund authorisation team may challenge the use of an SDR label at the point at which a fund authorisation application is submitted, the fact that the FCA approves the application itself does not constitute approval of the fund's SDR label.

In relation to ongoing supervision, the FCA has noted that it "will use available market intelligence that indicates firms may be in breach of SDR requirements", although it is not clear what specific sources the FCA will have regard to and whether these will be publicly available (e.g. commentary from ESG ratings and/or fund data providers.

Lastly, firms using SDR labels will also be required to use the graphic accompanying the particular label, which can be downloaded as part of the FCA notification process.

Our third briefing in this series covers the new labelling regime in more detail, and our fourth briefing discusses related operational requirements.

2. Distribution

The SDR regime extends beyond FCA-authorised firms and applies to any "distributor" or "firm which offers, sells, recommends, advises on, arranges, deals, proposes or provides a sustainability product or a recognised scheme…" (see the Annex to SDR alert A). The SDR contains a number of rules applicable to fund distributors, such as financial advisers and platform firms, with a view to enhancing retail investor understanding of the products that are being distributed.

The rules require distributors to communicate the SDR labels and provide retail investors with access to consumer-facing disclosures in respect of those funds that are required to produce such disclosures. Distributors must also include a notice on overseas products (i.e., recognised schemes – including Exchange Traded Funds) to clarify that those products are not subject to the UK sustainable investment labelling and disclosure requirements. The text of the notice is as follows: "[T]his product is based overseas and is not subject to UK sustainable investment labelling and disclosure requirements".

The FCA notes that the label and overseas product notice must feature in a prominent place on the relevant digital medium (i.e., the distributor's website and any mobile application or other digital medium the firm is using). Distributors not using a digital medium will need to communicate the label and notice via a channel that the distributor would ordinarily use to communicate information to retail clients. The notice must also include hyperlink to the relevant FCA webpage setting out further information on the regime for retail consumers.

Lastly, distributors are required to ensure that any labels and disclosures being attributed to certain products are updated in accordance with changes made by managers to their products.

On timing, the FCA has commented that it expects distributors to make the labels and consumer-facing disclosures available to retail investors "as soon as reasonably practicable" after the firm produces them. Distributors must comply with the FCA rules on sustainability labels and consumer-facing disclosures by 31 July 2024 and notices on existing overseas funds by 2 December 2024.

Given the critical role which distributors play in the investment chain, in addition to the SDR labelling regime, the FCA is also working on additional guidance to support advisers regarding sustainable finance.

Next steps

In preparation and before 31 May 2024 when the SDR is entered into force, distributors should take steps to:

(i) understand the universe of products which the SDR could affect;

(ii) prepare to make the SDR labels and consumer-facing disclosures available to retail investors;

(iii) ensure that disclosures are kept up to date following any changes made by the investment manager;

(iv) amend any relevant distribution agreements to ensure that the manager is required to make SDR-focused disclosures to the distributor;

(v) where relevant, prepare to add a notice on overseas funds to inform consumers that they are not subject to the regime; and

(vi) more generally, ensure compliance with the anti-greenwashing rule and update compliance policies accordingly (see our second briefing in this series for more information).

How does this stack up against the SFDR?

- In their current form, the SDR distribution rules do not capture financial advisers, although the FCA has noted that it is exploring how to clarify its expectations for investment advisers around taking sustainability matters into account in relation to suitability checks.
- The UK's approach contrasts with that taken in the EU, where firms conducting suitability assessments (required to be performed on clients prior to the provision of portfolio management services or investment advice) now need to assess their clients' sustainability goals. In addition, EU investment advisers may also be required to make detailed disclosures under the SFDR.
- HM Treasury and the FCA have taken a more measured approach thus far, and have not yet chosen to implement similarly sweeping standards into the UK regulatory framework. Notwithstanding this, it is clear that the FCA is continuing to explore exactly how investment advisers should build an assessment of sustainability into the service they are providing clients.

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